CHASE

International Finance

Vol. XIV, No. 23
November 26, 1979

Issued bi-weekly by the Economics Group of The Chase Manhattan Bank
for corporate customers and correspondent banks

Because of the Thanksgiving holiday, this issue of International Finance *went to press on November 21.*

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The Risks of Germany's Tight Money Policy

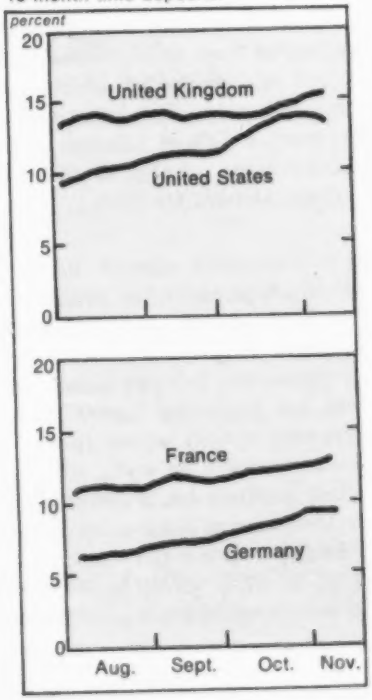
The German authorities continue to hold firm to a tight monetary stance. The recent rises in the Bundesbank's discount and Lombard rates to 6% and 7% consolidate the latest round of DM interest rate hikes. Three-month money market rates have risen throughout 1979, from less than 4% in January to their current 9.5%.

The higher interest rates are the result not only of the Bundesbank's tight monetary stance, but also of the strong growth in domestic demand. Real GNP advanced at an annual rate of over 4% in the first half of the year. The construction industry is now operating at full capacity, and unemployment is at a five-year low of 3.7%, with labor shortages beginning to emerge.

Thus, the Bundesbank has shifted its focus to curbing inflationary expectations. Germany's year-on-year inflation rate has risen from 2.9% in January to 5.7% in October, with much of the increase imported. Indeed, import prices in DM terms rose 17% over this period, while industrial unit labor costs remained flat. The German authorities fear that unless inflationary expectations are brought well below the current inflation rate, wage settlements this winter will internalize the higher rate as labor seeks to recoup much of the added real income transferred to OPEC. The Bundesbank is therefore holding central bank money growth to the lower end of its 6%-9% target range. It is hoped that this will reduce inflationary expectations, both by easing domestic demand pressures and strengthening the DM on foreign-exchange markets, thereby lowering import price inflation in DM terms.

In the face of Germany's restrictive monetary policy, its trading partners have been forced to choose between raising their own interest rates or allowing their currencies to decline vis-à-vis the DM. So far, they have opted largely for the former. But labor markets in these countries function less efficiently than in Germany, and inflationary expectations are more deeply entrenched, particularly in France, Italy, and the United Kingdom. Tighter monetary policy in these countries is thus more likely to affect output than prices, possibly turning a substantial economic slowdown into an outright European recession. Such an outcome would reduce German demand by far more than the Bundesbank is now bargaining for.

Money market rates, internationally
(3-month time deposits)



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U.K. determined to maintain tight money policy, despite the pound's growing strength.

Recent events pose a difficult dilemma for U.K. authorities. On the domestic front, loan demand remains stubbornly buoyant, despite high interest rates and an impending recession. As a result, the domestic money supply has increased at an annual rate of 14%, well above the Government's target range of 7%-11%. On the international front, the realization that sterling is becoming a petrocurrency has encouraged large capital inflows, which have boosted the pound's value to a level far above that justified by international comparisons of cost and price competitiveness. This threatens widespread unemployment in British export industries. At the end of October 1979, sterling's trade-weighted index stood at 66.9 (Smithsonian=100), compared with 63.1 one year earlier and a low of 59.1 in November 1976. Even the abolition of exchange controls in force since World War II led to only a temporary sterling weakness. Still, the Government is determined to stick to its policy of maintaining tight domestic monetary conditions, even if it leads to a further strengthening of the pound. The Bank of England's minimum lending rate has been raised from 14% to 17%, and an extension of the corset scheme for limiting bank lending growth has been announced. Immediately after the policy announcement, sterling jumped from $2.11 to $2.14 and from DM 3.78 to DM 3.82. In the long run, British investors' freedom to invest overseas may lead to large capital outflows. But for the time being, British exporters will have to continue living with an uncompetitive exchange rate.

A neutral 1980 budget proposed by Dutch authorities.

After a 24% annualized rise in the second quarter, third-quarter Dutch industrial production remained unchanged, and order figures point to a relatively sluggish performance for the rest of 1979. With a world slowdown increasingly likely in 1980, the Dutch authorities have proposed a broadly neutral, rather than deflationary, budget for 1980. The deficit of central and local governments is forecast to reach some 16.5 billion guilders, or 5.5% of GNP, compared with an estimated 5.7% this year. Selective job creation schemes, energy conservation incentives, and aid to the housing industry will be financed with a $2.1-billion-guilder increase in Dutch natural gas sales and higher taxes on cigarettes, alcohol, and gasoline. Moreover, income-tax bands will be inflation-adjusted by only 80%. Official forecasts accompanying the government proposals project real GNP growth of 2.5% for 1980, down from 3% this year; a 5.5%-6% inflation rate, up from 4.5% in 1979; and a gas-induced current-account surplus of one billion guilders, after approximate balance in the current account for 1979.

Denmark acts to reduce chronic payments deficit.

The prospect of a further deterioration in Denmark's chronic balance-of-payments deficit has led the new Government to adopt restrictive measures. An immediate freeze has been imposed on prices, dividends, and wages up to January 1, 1980, and the Government hopes to have reached agreement with unions and management by then on a more permanent incomes policy. In an effort to enlist union support, the authorities are proposing higher taxes on wealth and limits on offsetting interest on borrowing against income taxes. More important, the Government is proposing a power-sharing plan under which corporations would have to contribute 10% of their profits to an investment fund administered by the unions. If Denmark fails to reduce its balance-of-payments deficit to more manageable levels, it will be forced to lower the country's high standard of living—GDP per capita was $10,695 in 1978, versus $9,588 for the United States—by deflating its economy and accepting much higher levels of unemployment.

Japanese authorities act to curb capital outflows.

Outflows of long-term capital from Japan in the first nine months of this year totaled $8.5 billion, topping the $7.3-billion level for the comparable period last year. The large capital outflows have clearly had a negative impact on the Japanese economy. They are mainly the outcome of the gap between domestic and foreign interest rates, the mounting rate of inflation, and the weakness of

the yen. To reverse the trend, the Government has attempted to encourage capital inflows by liberalizing the money market. Restrictions on foreign borrowings have been relaxed, and the authorities have abolished the limit on purchases by foreign investors of new yen bonds and the ban on non-residents' participation in the "Gensaki" market for Japanese bonds. In addition, discount rates were raised three times in the last six months to narrow the differential between Japanese and foreign interest rates, and Japanese banks were given "guidance" to scale down their overseas lending. While these actions should help reduce the rate of capital outflow in the next few months, the total amount of outflows for 1979 will remain sizeable, at $10 billion or more. This will continue to be one of the influences working to undermine the strength of the yen in the near future.

Inability to check credit growth a major factor in Hong Kong inflation.

Hong Kong's inflation, currently running around 16%-17% on an annual basis, is characterized by a real estate and stock market boom and soaring rents. Factors contributing to the rapid inflation include the large hike in oil prices, the entry of many new firms and banks anxious to participate in trade with China, and a renewed flow of Chinese immigrants, which is putting pressure on housing, transport, and public services. The Government, however, has cited the rapid credit expansion, particularly by foreign banks, as a key influence. With an entirely free exchange market and no central bank, Hong Kong authorities are unable to block credit growth, nor can they directly govern interest rates, which are now two to three percentage points below the inflation rate. The Government has recently threatened a more interventionist approach to monetary policy, but breaking the long-held tradition of free-market policies will not be easy.

Morocco's external deficit curbed by import controls and capital inflows.

Morocco's trade deficit narrowed significantly in 1978 to $1.14 billion. The decline is partly attributable to a 7% rise in merchandise exports, but is mainly the result of a 14% fall-off in imports caused by the imposition of import restrictions and reduced capital spending in the context of an austerity program. The smaller trade gap, coupled with a services deficit of some $960 million and an 18% increase in net transfers to $750 million, helped lower the current-account deficit in 1978 to $1.35 billion from $1.83 billion in 1977. The current-account gap for 1979, however, is unlikely to narrow further, despite the slower pace of economic activity. First-half statistics show the trade gap holding at just about its corresponding 1978 level, with a 12% increase in exports offset by a 7% climb in imports. The higher imports can be traced to the marked rise in the cost of fuel and intermediate goods imports. Although the fuel import bill will continue to climb in the second half, the 1979 current-account gap is not expected to exceed last year's deficit by a wide margin because of the expected further rise in exports, additional import restrictions, a rise in worker remittances, and indications of a larger inflow of official grants.

Cotton share in world fiber market to increase, but prices will weaken.

Despite the late August hail storms in western Texas, the U.S. 1979/80 cotton crop is currently estimated at a near record 14.2 million bales, up more than 30% from the unusually low level of last year. World output is estimated at slightly more than 64 million bales, compared with a 1978/79 level of about 60 million bales. World demand for cotton, which exceeded production last year, will be weakened in 1980 by the recession in the United States and economic slowdowns in other countries. Offsetting this to some extent will be stepped-up export demand from mainland China, the introduction of a permanent-press all cotton shirt this year, and the narrowing price differential between cotton and synthetic fibers stemming from rising costs of petroleum-based feedstocks. Although these factors will probably lead to an increased market share for cotton, it should not be sufficient to prevent a significant rise in cotton inventories accompanied by declining prices.

Bank Borrowing Continues Strong

Growth of overall domestic borrowing from U.S. banks has remained relatively strong, despite the record-high interest rates in the aftermath of the Federal Reserve's early-October tightening moves. Of late, a large part of the borrowing has been by individuals in the form of real estate and personal loans. A resurgence in business borrowing, however, is expected before the end of the year. If such an upturn is coupled with continued rapid expansion of loans to other sectors, funding pressures for banks will increase appreciably.

Total non-business borrowing from commercial banks has been growing at a steady 20% annual rate since early this year, uninterrupted by the October 6 credit-tightening moves. Indeed, in recent weeks loans to individuals for personal expenditures have risen at a 30% annual rate, up from 20% in September. While the outlook is for a moderation of this pace in the weeks ahead, consumer credit demand is nevertheless expected to show seasonal strength during the coming holiday season. Moreover, borrowing from banks by sales finance and personal finance companies increased slightly in October following a drop in September. Much of the finance company relending is ultimately consumer-oriented. In addition, there has been no pause thus far in the strong growth of real estate lending by commercial banks, which has persisted in the 25%-30% range since early spring.

By contrast, business borrowing from banks since mid-October has risen relatively little. However, at New York banks as well as banks outside the city there are expectations of a spurt in business borrowing in the final weeks of 1979. This upturn would reflect slower payments on deliveries, squeezes on profit margins resulting from the business slowdown and from escalating costs, some inventory build-ups, and temporary financing needs linked to corporate tax payments in mid-December.

Overall, total bank loans have risen almost $4 billion, or 11%, in the weeks following the Federal Reserve's tightening actions. Bank funding pressures generated by this expansion have been exacerbated by the bite imposed by the new marginal reserve requirements. Some banks have already exceeded their exempt base for managed liabilities and must now meet the added 8% requirements on net increases of short-term large certificates of deposit, Eurodollar borrowings, certain repurchase agreements, and Federal funds borrowings from non-member institutions. By mid-November, required marginal reserves on these managed liabilities totaled nearly $1 billion. In short, it seems likely that banks will have sizable funding pressures at least through year-end, and possibly longer.

Europe, Canada & U.S. Bimonthly Survey of Business and Finance

COUNTRIES	CURRENT BUSINESS CONDITIONS	INDUSTRIAL OUTPUT		GNP IN 1978		BALANCE O				
		3-months ending	change from year earlier	in billions of dollars	real growth	latest data	reserves in millions of dollars	12-month change	months of imports covered	use o credit lions of
Austria	Economic growth continues strong, but is expected to slow in 1980.	May	+ 3.6%	58.1	+ 1.5%	Sept.	4,853	— 7.6%	3.2	
Belgium	Growth to slow in 1980; official forecast of 2.5% likely to prove optimistic.	July	+ 8.4%	96.1	+ 1.6%	Sept.	7,440	+ 30.7%	1.7	
Britain	Recent statistics confirm an economic slowdown.	July	+ 6.0%	308.2	+ 3.2%	Sept.	20,705	+ 17.6%	2.8	1,15
Denmark	New wage and price freeze expected to reinforce deflationary pressures in the economy.	July	+ 4.9%	55.5	+ 1.0%	Sept.	3,446	+ 15.1%	2.5	
Finland	Output remains high, but signs of a future slowdown emerging.	July	+ 9.0%	32.2	+ 2.5%	Sept.	1,979	+ 57.3%	2.5	8
France	Economic activity reviving again following summer stagnation.	June	+ 0.4%	470.5	+ 3.3%	Sept.	19,585	+ 49.8%	2.4	
Germany	Industrial orders beginning to weaken; construction industry overheated.	Aug.	+ 6.5%	639.2	+ 3.1%	Sept.	56,668	+ 26.9%	4.7	
Greece	Fiscal policy turns restrictive as economy overheats; growth expected to decline in 1980.	June	+ 7.7%	31.4	+ 6.2%	Aug.	1,132	— 1.1%	1.8	2
Iceland	Latest indicators point to 2.5% GNP increase this year, versus 4.2% in 1978.	May	+20.5%	2.1	+ 1.4%	Sept.	143	+ 67.3%	2.4	
Italy	Economic activity picks up after summer slack, but growth set to decline next year.	July	+ 3.4%	237.0	+ 2.6%	Sept.	21,772	+ 54.3%	3.9	
Netherlands	Export-led slowdown seen for 1980; broadly neutral budget proposed.	Aug.	+ 1.9%	130.5	+ 2.5%	Sept.	9,863	+ 23.5%	1,9	
Norway	Rapid economic growth continues, led by expanding oil sector.	Aug.	+ 6.0%	39.7	+ 3.5%	Sept.	4,293	+ 44.5%	4.1	
Portugal	Domestic economy showing signs of increased activity after first-half stagnation.	Apr.	+ 5.3%	18.3	+ 3.2%	Aug.	1,749	— 0.9%	4.0	2
Spain	Domestic demand remains depressed, providing spur for exporters.	June '78	+ 5.4%	141.2	+ 2.9%	Apr.	11,724	+ 54.8%	6.8	2
Sweden	Economic growth slowing, but inflation beginning to accelerate.	Aug.	+ 9.0%	87.2	+ 2.8%	Sept.	3,900	— 12.8%	1.8	
Switzerland	Wage demands beginning to show influence of recent rise in inflation rate.	June	— 1.9%	84.4	+ 0.9%	Sept.	18,841	+ 20.8%	8.2	
Canada	Business slowdown expected as U.S. recession and higher interest and oil costs have impact.	July	+ 3.4%	206.0	+ 3.4%	Sept.	4,511	+ 23.0%	1.0	
United States	Real consumer spending resumes its decline following end-of-summer surge.	Oct.	+ 2.3%	2,098.6	+ 4.0%	Sept.	18,534	0	1.2	

How Deep A Recession?

Recent economic statistics lend credence to the view that the much-heralded recession is truly under way. Housing starts fell 8% in October to a seasonally adjusted annual rate of 1.76 million, and permits for future construction dipped by an even greater 13%. Retail sales dropped nearly 2% after the end-of-summer surge, as auto sales fell from an annual rate of 10.8 million in September to 9.4 million in October. Since consumers and businesses have not had time to adjust their behavior fully to the credit-tightening moves by the Fed on October 6, further fall-offs in activity seem likely. Economists' concerns now focus on the depth and duration of the emerging recession.

As a guide, consider some parallels between the present and the 1973-75 periods. In 1973 and 1978, the U.S. economy attained its maximum potential output: capacity utilization in industry was high and unemployment was near its "full-employment rate."

Some sectors, however, were already declining by the autumn of 1974. Housing starts were about one-third below the year-earlier figure because of the correction of previous private speculative overbuilding, the reduction of huge government subsidies, and deposit outflows at thrift institutions. Auto sales, which reached a record 12.9 million annual rate in March 1973, had fallen below 10 million during the summer of 1974, a response to declining personal income. Personal income—adjusted for inflation and taxes—fell at an annual rate of 7% in the first quarter of 1974 in response to the unanticipated rising oil prices. It fell an additional 1% in the second and third quarters, leading to cutbacks in non-auto consumption as well. Both housing and auto sales fell another 20% in the next several months. The huge reduction in taxes in the spring of 1975 boosted income and ultimately helped turn the economy around.

Thus far in 1979, the declines in activity have not been as severe as in 1974, nor are they likely to be. There are no widespread world shortages of materials that led to overzealous stockpiling by businesses in 1973-74, although automakers must reduce bloated inventories. Homebuilders have also been much more cautious, and overbuilding has been avoided in this expansion. Furthermore, deposit flows at thrifts have been propped up somewhat by money market certificates. Consumption and real disposable personal income were bolstered in the first quarter of 1979 by a tax cut. However, this relief was short-lived, as real income fell at an annual rate of more than 1% in the second and third quarters.

With inflation outstripping previous expectations, the continuing decline in real consumer incomes ensures that a broader retrenching in consumption, production, and employment lies ahead. But the lack of excesses should prevent the economy from plunging as deeply as it did in early 1975.

PAYMENTS		MONEY AND BANKING							COUNTRIES
		12-month changes							
MF il- llars	current influences on payments	latest data	consumer prices	latest data	domestic credit	central bank rate	exchange rate in U.S. dollars	current monetary conditions	
						November 20, 1979			
	Strong exports reduce current-account deficit below earlier forecasts.	Aug.	+ 3.3%	June	+16.3%	3.75%	.0785	Interest rates continue firm.	Austria
	Heavy foreign borrowing to cover current-account deficit and capital outflow.	Sept.	+ 4.5%	June	+14.6%	10.00%	.03499	Monetary conditions remain restrictive.	Belgium
	Jan.-Oct. cumulative trade deficit at $5.2 billion.	Oct.	+17.2%	Mar.	+ 4.7%	17.00%	2.1730	Domestic credit growth triggers large increase in MLR.	Britain
	Jan.-Sept. trade deficit of kr.14.5 billion, versus kr.11.1 billion in 1978.	Aug.	+12.3%	May	+ 4.2%	11.00%	.1922	EMS obligations force maintenance of high interest rates.	Denmark
	Jan.-Sept. trade deficit of only 101 million markkaa.	Aug.	+ 7.4%	May	+ 9.3%	7.25%	.2653	Markkaa remains strong following revaluation.	Finland
	Trade deficit for 1979 estimated at 10 billion francs.	Sept.	+11.0%	Dec.	+12.4%	9.50%	.2421	Rate hikes abroad lead to higher French interest rates.	France
	Current account remains in deficit; foreign orders decline.	Sept.	+ 5.3%	July	+12.9%	6.00%	.5675	Money policy very tight for upcoming wage round.	Germany
	Current-account gap to top $2 billion in 1979; small narrowing likely in 1980.	Aug.	+20.8%	Apr.	+22.5%	14.00%	.0270	Credit growth limits reduced to 16%; interest rates raised.	Greece
	Higher oil prices likely to produce small balance-of-payments deficit.	Aug.	+41.9%	Aug.	+34.0%	20.50%	.0328	Inability to control money growth fueling high inflation.	Iceland
	Balance of payments posts Lit.589-billion deficit in September.	Oct.	+18.2%	Apr.	+14.7%	12.00%	.001211	Interest rates set to rise further.	Italy
	Higher value of gas exports to offset non-gas export volume decline.	Oct.	+ 4.5%	June	+17.7%	8.50%	.5077	Monetary conditions moderately restrictive.	Netherlands
	Jan.-Aug. current-account gap of kr.4.3 billion, versus 7.6 billion year ago.	Sept.	+ 3.5%	July	+18.4%	7.00%	.2000	Credit conditions continue restrictive.	Norway
	Current account showed surplus of $220 million for first half.	July	+26.9%	June	+19.8%	18.00%	.0210	Large budget deficit makes monetary control difficult.	Portugal
	Continuing rises in reserves imply strong current-account improvement.	July	+15.7%	July	+15.6%	8.00%	.0153	Monetary growth slowing in response to tough credit policy.	Spain
	Payments deficit forces $800-million loan on world capital market.	Aug.	+ 8.2%	Apr.	+21.7%	8.00%	.2382	Interest rates raised to stimulate capital inflow.	Sweden
	Sept. trade gap of SF 445 million, vs. SF 104 million surplus year ago.	Oct.	+ 5.0%	July	+12.6%	2.00%	.6090	Rate tightening anticipated to curb inflationary expectations.	Switzerland
	Capital inflows offset services deficit.	Oct.	+ 9.3%	May	+24.9%	14.00%	.8511	New act would permit foreign bank entry.	Canada
	Current-account surplus anticipated for 1980.	Sept.	+12.1%	Oct.	+15.3%	12.00%	—	Fed's tight credit policy to continue.	United States

World Interest Rates

market rates of November 21, 1979; bond yields as of November 16, 1979

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	12.00	14.00	17.00	10.00	9.50	6.00	12.00 penalty rate 15.00	8.50	2.00	6.25
Day-to-Day Money	12.75	14.00	n. a.	11.00	12.25	7.60	12.50	9.50	1.75*	7.6875*
Treasury Bills 91-day, Middle Rates	12.12	13.60	n. a.	14.25 120-day	n. a.	n. a.	11.97 100-day	no dealing	no market	5.125* 2-month
Commercial Paper prime, 3-month, asked	12.75 finance paper	14.15 finance paper 15% tax w/h	n. a.	9.90 Certified	13.00 Interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	13.60	14.15 15% tax w/h	n. a.	12.00 Certified	not traded	7.40	14.75	no market	3.00* not traded	no market
Government Bonds Long-term, new and old issues, average yield	10.40	11.48	14.25	7.52 20% tax w/h	10.58	8.11	13.54	9.29	3.76*	8.14
Industrial Bonds prime, long-term, new and old issues, average yield	10.60 Aa Industrials	11.75	14.39	12.16 20% tax w/h	12.19	8.31	14.10	9.75	5.07*	6.95
Bank Short-Term Rate to Best Borrowers (prime rate)	15.75	15.00	n. a.	14.25	13.10	7.25	17.00	12.50	4.00*	6.50*
Bank Time Deposits 3-month	13.625 Cert. of Dep.	14.05 Cert. of Dep.	n. a.	14.35	13.00	9.40	10.00	12.25 large deposits	4.00* residents only	4.00* 20% tax w/h
Eurocurrencies 3-month, asked	15.00	no market	17.625	no market	13.8125	8.75	no market	10.625	3.875	no market
Exchange Rates—in U.S.$ rates floating against the $	—	.8511	2.1730	.034990	.2421	.5675	.001211	.5077	.6090	.004065
Forward Exchange Cover 3-month, in percent p.a. *D* = discount, *P* = premium	—	1.00 *P*	1.75 *D*	.875 *P*	.875 *P*	6.125 *P*	2.375 *D*	4.125 *P*	11.125 *P*	7.125 *P*

Eurodollar Deposits
(London, interbank, bid) November 21

7-day	13.25
1-month	13.8125
3-month	14.875
6-month	14.875

International Arbitrage
(3-month, hedged) + *in favor of U.S. dollars*

U.S.-U.K. Treasury Bills	n. a.
U.S.-Canada Treasury Bills	−1.86
U.S.-Canada Finance Co. Paper	−2.20
Eurodollars-U.K. Local Auth. Deposits	n. a.

Eurbonds
(average yield on recent straight debt issues)

U.S. Dollar Bonds	
7 yrs. and under	11.875
Over 7 yrs.	11.75
DM Bonds	
7 yrs. and under	8.25
Over 7 yrs.	8.50

Gold Price

London afternoon fixing

396.15
(per fine ounce)

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.
* Market rates as of November 14; bond yields as of November 9.

Current economic indicators of major industrial countries

	U.S.	Canada	Britain	France	Germany	Italy	Switzerland	Japan
Consumer prices*	12.1 (Sept.)	9.3 (Oct.)	17.2 (Oct.)	11.0 (Sept.)	5.3 (Sept.)	18.2 (Oct.)	5.0 (Oct.)	3.1 (Sept.)
Industrial production*	1.8 (Oct.)	−0.1 (Aug.)	−0.8 (Sept.)	3.0 (Sept.)	3.4 (Sept.)	5.9 (Sept.)	−1.9 (June)	6.9 (Sept.)
Trade balance† *(billions of local currency units)*	−$2.8 (Sept.)	C$.641 (Sept.)	−£.100 (Sept.)	−FF2.9 (Oct.)	DM1.9 (Sept.)	−Lit421 (Sept.)	−SF.445 (Sept.)	−¥103 (Sept.)
Money supply (M_1)*	4.8 (Oct.)	8.5 (Oct.)	12.4 (July)	12.0 (Aug.)	11.1 (Aug.)	19.9 (June)	13.8 (July)	8.9 (Sept.)
Velocity of money (M_1)*	6.6 (June)	5.4 (June)	−4.0 (Mar.)	−5.8 (Dec.)	−3.9 (June)	−5.6 (Dec.)	n.a.	−4.4 (June)
Reserves *(millions of U.S. $, end of period)*	18,534 (Sept.)	4,511 (Sept.)	20,705 (Sept.)	19,585 (Sept.)	56,668 (Sept.)	21,772 (Sept.)	18,841 (Sept.)	25,647 (Sept.)

* Percent change from 12 months earlier.
† Figures are only for the month indicated.

Books: The "New Order" Revisited

Karl Brunner, editor, The First World & the Third World: Essays on the New International Economic Order. *University of Rochester Policy Center Publications, 1978. 272 pages. $9.95 (cloth), $3.95 (paper).*

Martin M. McLaughlin and the Staff of the Overseas Development Council, The United States and World Development: Agenda 1979. *Praeger, 1979. 268 pages. $18.95 (cloth), $5.95 (ODC edition, paper).*

W. Scott Thompson, editor, The Third World: Premises of U. S. Policy. *Institute for Contemporary Studies, 1978. 332 pages. $5.95 (paper).*

Five years have passed since the United Nations General Assembly first sounded its clarion call for a New International Economic Order that would reshape the world economy in the interests of Third World development. Although not much has been accomplished in these years toward meeting the impassioned demands of the New Order, the U.N. is pushing ahead with plans to launch its third "Development Decade" next year with a special session documenting the NIEO's progress. But even as the preparations proceed, there are signs that the NIEO—grounded more in ideology than realism—is becoming less and less relevant to the pressing issues that bear on the growth and prosperity of the poorest nations.

In light of these circumstances, it seems clear that the development effort is badly in need of a sober reappraisal of the principles and programs that constitute the NIEO. Fortunately, a spate of books has recently appeared that should aid materially in such an assessment. The three volumes listed above are all collections of short articles and essays that deal with various aspects of political and economic relations between the less-developed countries (LDCs) and the industrialized market economies. Taken together, they present a comprehensive portrayal of the problems of the NIEO, along with suggestions for more workable approaches to international development.

For better or worse, little of substance has transpired since the U.N. adopted its NIEO declaration in the spring of 1974, followed by a "Charter of Economic Rights and Duties of States" in December of that year. The economic policy changes contemplated by the New Order included commodity agreements to raise and index prices of primary products, vast resource transfers to the LDCs in the form of foreign aid, assured access to Western technology and markets, and the unquestioned right of every state, as asserted in the 1974 Charter, "to nationalize, expropriate, or transfer ownership of foreign property."

The resolutions were aimed at extracting compensation, or retribution, from the rich countries for alleged past wrongdoings. World trade relationships were to have been restructured in the process, to give favored treatment to Third World exports. But few of the programs have moved beyond the debating halls.

Overtaken by events

A principal reason for the failures of NIEO proposals and doctrines is their increasing irrelevance to current reality. This is persuasively argued by Columbia University Professor Nathaniel Leff in his essay in the Thompson publication. As Leff points out, major international political and economic shifts since 1974 have altered the context, if not the rhetoric, of the North-South dialogue. Chief among these new elements has been the rising price of oil, engineered by a powerful LDC cartel—OPEC—whose actions have severely damaged the development prospects of the non-oil LDCs.

"For most LDCs," writes Leff, "the prospects for attaining high rates of economic growth in the face of the oil-price import constraint are bleak." The oil price hikes, along with other political and economic changes, "have removed the NIEO from the international policy agenda insofar as one is concerned with helping the developing countries."

Leff argues that NIEO rhetoric is serving essentially as a tactic for sustaining LDC support of OPEC's pricing policies. That is, the oil-consuming LDCs have been trapped by NIEO ideology into backing OPEC actions detrimental to their own economic well-being. "With superb diplomatic skill," says Leff, "OPEC has succeeded in maintaining the allegiance of the oil-importing LDCs—despite the impact of higher petroleum prices on Third World economic growth, foreign debt, and external dependency. OPEC has achieved this feat, not by selling the LDCs oil at substantially concessionary prices," he says, but by invoking the mystique of NIEO solidarity.

Leff's incisive observation was dramatically substantiated just last week by news reports from the United Nations. Word filtered out that a plan by oil-consuming countries to press OPEC for stabilized prices and supplies has been scuttled by the Group of 77—the LDC bloc in the U.N. that now numbers 119 countries, including the members of OPEC. According to the reports, the oil-importing LDCs have decided to forgo a push for oil price and supply stability in return for an uncertain possibility of some modest cash transfers from the oil producers. Apparently, in the name of Third World NIEO solidarity, the non-oil LDCs are still willing to act against their own best interests.

Political as well as economic shifts have served to render much of the NIEO agenda obsolete. For ex-

Books: The "New Order" Revisited *(continued from page 7)*

ample, according to Leff, as foreign-exchange constraints intensify in the LDCs, many of them have softened their hostility to multinational companies and are welcoming foreign private investment. Moreover, the massive resource transfers contemplated by the New Order have fallen victim, at least in the United States, to changing perceptions by U.S. supporters of foreign aid. NIEO's erstwhile American proponents, writes Leff, have "come to recognize the inherent inconsistency between a large U.S. developmental role and a reduction in LDC dependence." Furthermore, U.S. foreign aid supporters have shifted their focus to such themes as basic needs, human rights, employment growth, and income redistribution—issues for which most LDC governments have shown little enthusiasm. These disagreements have reduced the possibility of a consensus between the LDCs and the U.S. development community over resource transfers.

Fundamental flaws

Beyond the recent setbacks to the New Order, Leff and several other authors in the Thompson and Brunner volumes make a strong case that the fundamental proposals of the NIEO were flawed from the start. For example:

- Commodity prices. As the late Harry G. Johnson points out in the Brunner collection, prices are inadequate proxies for income and wealth. Schemes to raise commodity prices will not all necessarily be as successful as the OPEC effort; in many cases they will cut sharply into demand and reduce income and employment in the producing countries. Furthermore, the higher prices will work both ways, as in the case of oil, since most LDCs import as well as export primary products.

- Resource transfers. Although increases in foreign aid are likely to bring some acceleration of development, "the contribution of these external transfers is at best marginal," argue Peter T. Bauer and Basil S. Yamey of the London School of Economics in the Brunner book. Along with other authors, they point out that many LDCs have limited capacity to absorb foreign capital and that foreign aid can adversely affect mobilization of private capital for development.

- Transfer of technology. Bauer and Yamey are also dubious about the beneficial effects of accelerating the importation of technology by LDCs. "Gratis or subsidized technology transfer is not readily adjusted to complementary factors, market conditions, and institutions," they maintain.

Given the defects of the NIEO proposals, authors in all three volumes generally agree that a more constructive approach to international economic relations will have to emerge if the world development effort is to get off dead center. A World Bank official from Pakistan, Mahbub ul Haq, writing in the Overseas Development Council collection, argues that the international community "should focus its primary attention on exploring areas of common interest" between the two camps. He calls for liberalization of trade barriers rather than establishment of trade preferences for LDCs, a freer flow of labor across national frontiers, and specialization by LDCs "in industries where their comparative advantage is the greatest." He also calls on LDCs to "provide a legally stable framework within which multinationals can operate without undue uncertainty."

In this call, Haq is echoed by many writers in the other books who see a return to market principles as the best hope for world economic development. As Wilson Schmidt of the Virginia Polytechnic Institute argues in his essay in the Thompson book, the international capital market must be allowed to operate freely. If it is, it will provide ample transfers of private capital to LDCs from the rich countries, where the rate of return on capital is lower. "Capital transfers that provide mutual gains," says Schmidt, "are the most viable option to enhance the economic well-being of the poor." It remains to be seen whether the United Nations is ready to accept such a "radical" proposal for its third Development Decade.

Ronald A. Krieger

The Development Gap, by Groups of Countries

	Population, mid-1978 (millions)	Average per-capita GNP, 1976 (US$)	Physical Quality of Life Index (PQLI)*	Birth rate per 1,000	Death rate per 1,000	Rate of natural population increase	Average life expectancy (years)	Infant mortality per 1,000 live births	Average adult literacy rate
Developing Countries (141 countries)	3,163.7	494	56	33	12	2.1%	56	102	49%
Developed Countries (28 countries)	1,052.6	5,036	94	16	9	0.7%	72	18	98%
World (169 countries)	4,216.3	1,628	65	29	11	1.8%	60	81	62%

* PQLI for each country is calculated on the basis of life expectancy, infant mortality, and literacy rates. "Developed" countries are defined as those with per-capita GNP of $2,000 or more and a PQLI rating of at least 90.

Source: Overseas Development Council data, as presented in statistical annex to Martin M. McLaughlin *et al., The United States and World Development: Agenda 1979* (New York: Praeger, 1979).

CHASE

International Finance

Vol. XIV, No. 24
December 10, 1979

Issued bi-weekly by the Economics Group of The Chase Manhattan Bank
for corporate customers and correspondent banks

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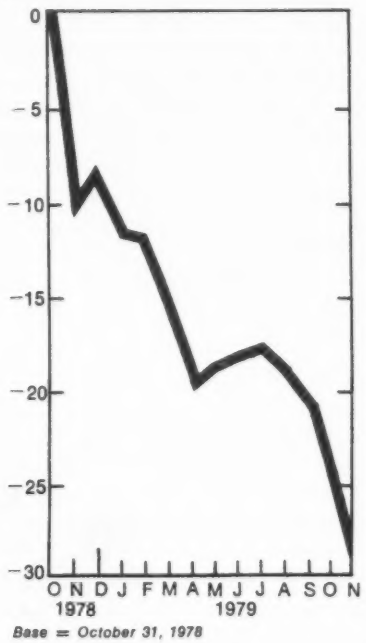
The next issue of International Finance *will appear on January 7, 1980.*

Japan's Yen-Defense Package

Japan has moved to stabilize the yen, but the market remains uncertain as to whether the actions taken will prove sufficient. The November 27 package was in fact quite modest in scope. The current import settlement program—an import subsidy scheme of limited impact—was suspended. The ceilings on foreign-currency holdings of Japanese banks and foreign banks in Japan were raised. The guidelines on foreign-currency loans to overseas Japanese borrowers were broadened. And a more elaborate and timely set of reporting requirements on foreign-exchange transactions, foreign-currency holdings, and purchases of securities denominated in foreign currencies was established. More interesting than what *was* done was what *was not*. The discount rate was held at the 6.25% level set on November 2. And a system of administrative controls designed to reverse the build-up of "leads and lags"—early payment for imports and delayed conversion of export earnings—was not put in place.

Yen depreciation against the dollar

percent



Base = October 31, 1978

What these moves indicate most clearly is the uncertainty of the authorities as to how best to cope with the inherent conflicts between the three main objectives of Japanese monetary policy: the avoidance of wide swings in domestic interest rates, exchange-rate stability, and the gradual internationalization of the yen. The key element of policy continues to be a commitment to a style of monetary management that stresses allocation of credit by administrative decision—"window guidance"—rather than by price. Thus, although credit conditions in Japan are currently very tight, the differential between yen and dollar interest rates remains considerably larger than the difference between expected inflation rates. In the past, administrative controls would have constrained the inevitable tendency to capital outflow in such a market environment. But the freeing of capital movements associated with the move toward internationalization of the yen has relaxed this constraint.

Yen weakness was inevitable given the extreme uncertainty over the availability and price of oil and the deterioration of the Japanese current account, but the increased volatility of short-term capital movements has greatly magnified this downward pressure. Should a further attack on the yen occur, the authorities may well reverse course and implement a system of administrative controls designed to bring capital outflows under stricter control. But it is by no means certain that these controls would be highly effective.

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Belgian authorities opt for budget austerity and foreign borrowing.

The Belgian economy remains in high gear. GDP growth is expected to reach 3.5% this year, compared with 2.5% in 1978. The balance-of-payments deficit has begun to widen, however, and inflationary pressures have intensified. Another cause for concern has been the series of speculative raids on the Belgian franc over the course of this year. The Government has responded to these developments by requesting major commercial banks to arrange for a $1-billion loan on the international capital market, with additional foreign borrowings anticipated. The authorities have also unveiled an exceptionally austere budget for 1980. Expenditures are to be cut and tax receipts increased, with the added revenues to come from higher taxes on gasoline and new taxes on highway usage. The Government's budget deficit is scheduled to remain constant in nominal terms, thus reducing its share of GDP from 7% in 1979 to 6.5% in 1980.

High inflation and external-account deterioration plague Swedish economy.

Sweden's declining economic performance is in large part the result of higher oil prices and the impending world recession. The major results are rising inflation and balance-of-payments deterioration. Domestic inflation has accelerated, reaching an annualized 8.4% in October, versus 5.9% at the start of the year, and the producer price index—up 12% over the last twelve months—promises still further increases. The high inflation has already triggered compensatory wage demands that have been met as part of the current national wage settlement. As for the current-account balance, a deficit of kr. 10 billion has been officially estimated for the January-August period. And a considerably worse figure is expected for the year as a whole, in contrast with a deficit of only kr. 4.6 billion in 1978. In response, the authorities have announced plans to borrow $800 million abroad. They have also tightened domestic credit, raising the official discount rate three times in the last five months to its current record level of 9%.

New Zealand's current-account deficit to widen.

New Zealand's current-account deficit is expected to widen in the current fiscal year ending March 31, 1980. Overall export growth will slow to less than 10%, versus 22% in fiscal 1978/79, as a result of weaker demand for wool and dairy products—which account for almost one-third of total exports. Earnings from meat exports, about one-quarter of total export receipts, rose 33% in the first five months of this fiscal year, but growth is slowing in the second half because of decreased domestic availability of cattle for slaughter. Manufactured exports, up some 30% in the first five months of the fiscal year, are expected to continue firm as a result of the June 1979 devaluation of the New Zealand dollar. On the import side, rising oil and commodity prices will boost import expenditures about 10% in FY 1979/80, up from 7.5% growth last year. Although the trade surplus will expand to $650 million from $606 million in FY 1978/79, higher debt-service payments and freight costs will widen the current-account deficit to $555 million from $477 million last fiscal year.

Korea courts orderly transition of political power.

The death of President Park on October 26 promised a period of potential uncertainty for Korea. Just one month after the assassination, however, the Government of acting President Choi Kyu-Hah appears to be functioning smoothly. Stabilization policies implemented at the end of 1978 are being maintained, and no abrupt policy shifts or major initiatives, such as devaluation, are likely to be undertaken by the interim government. Meanwhile, the high inflation rate persists, and the balance of payments on current account is deteriorating—a deficit of at least $3.5 billion is expected for 1979. Although inflation should moderate in 1980, higher oil prices and a U.S. recession threaten an even larger current-account gap. As a result, Korea's need for loans from abroad will continue strong. An awareness of the need to preserve international creditworthiness, along with the fear of North Korea, are strong incentives favoring a peaceful transition of political leadership.

The Chase Introductory Seminar on International Financial Management

February 4-8, 1980	*Fontainebleau*	*Miami, Florida*
March 17-21, 1980	*Kahala Hilton*	*Honolulu, Hawaii*

How do the international capital and money markets function? What are the risks in international financial transactions—and what protective measures are available? How can one best cope with complex currency regulations?

Experienced international financial managers may know the answers to these questions. But what about the finance manager who has just been given international responsibility or the executive who is considering international expansion?

Chase Manhattan's Multinational Financial Services Division has designed a four and one-half day seminar especially for those executives with little or no experience in international financial management, who must develop insights and skills as rapidly as possible. It's a *work*-seminar conducted by Chase experts who have profit responsibility for their respective areas—people who know the ropes and can point the way.

This seminar has been presented for the last two years in various locations and has attracted attendees from corporations, financial institutions and governments around the world. The mix of theory and practice has had global appeal since the problems associated with international operations and transactions are universal. Throughout the seminar, attendees are encouraged first to absorb the theoretical outlines of the subjects discussed and then to see them applied in practice. Actual problem solving sessions are incorporated into the program to simulate the kind of situations that participants will confront in their internationally oriented positions.

Examine the outline below and join the hundreds of previous attendees that have found the seminar to be an enormously useful experience. A registration form is provided.

Day I—Monday

(1) Introduction and Overview	9:00 a.m.- 9:30 a.m.
(2) Understanding International Economics—Our present monetary system	9:30 a.m.-10:45 a.m.
10:45 a.m.-11:00 a.m. Coffee Break	
(3) Forecasting foreign exchange rates—the economic variables	11:00 a.m.-12:30 p.m.
12:30 p.m.-2:00 p.m. Luncheon	
(4) The foreign exchange markets—terminology, institutions, practices	2:00 p.m.- 5:00 p.m.
3:30 p.m. Coffee Break	

Day II—Tuesday

(5) International Accounting	9:00 a.m.-10:30 a.m.
10:30 a.m.-10:45 a.m. Coffee Break	
(6) The fundamental theories of international finance and their ramifications	10:45 a.m.-12:15 p.m.
12:15 p.m.-1:45 p.m. Luncheon	
(7) International financial risks— defining and analyzing foreign exchange exposure	1:45 p.m.- 3:15 p.m.
3:15 p.m.-3:30 p.m. Coffee Break	
(8) Protection from financial risks—traditional hedging and covering techniques	3:30 p.m.- 5:00 p.m.

Day III—Wednesday

(9) Problem solving workshop— foreign exchange transactions and related problems	9:15 a.m.-12:15 p.m.
10:30 a.m.-10:45 a.m. Coffee Break	
12:15 p.m.- 1:45 p.m. Luncheon	
(10) Exchange controls—what, how, why?	1:45 p.m.- 3:15 p.m.
3:15 p.m.-3:30 p.m. Coffee Break	
(11) International Cash Management	3:30 p.m.- 5:00 p.m.
Evening—Chase Sponsored-Cocktail Reception	6:00 p.m.- 7:00 p.m.
Dinner	7:00 p.m.

Day IV—Thursday

(12) Special Techniques in International Finance, Swaps, intercorporate clearings, parallel loans, back to backs	9:00 a.m.-10:00 a.m.
(13) Analyzing International Financial Transactions	10:00 a.m.-11:00 a.m.
11:00 a.m. Coffee Break	
(14) Evaluating overseas subsidiary performance	11:15 a.m.-12:30 p.m.
12:30 p.m.-2:00 p.m. Lunch	
(15) International Capital markets, national sources of funds	2:00 p.m.- 3:30 p.m.
3:30 p.m. Coffee Break	
(16) Techniques in international trade financing	3:45 p.m.- 5:00 p.m.

Day V—Friday

(17) International Taxation	9:00 a.m.-10:30 a.m.
10:30 a.m.-10:45 a.m. Coffee Break	
(18) The cost of capital for the MNC	10:45 a.m.-11:30 a.m.
Borrowing foreign currencies	11:30 a.m.-12:00 p.m.
Seminar ends at	12:00 noon

Introducing the discussion leaders

Gerald Kramer – *Vice President,* Multinational Financial Services Division.

Mr. Kramer's primary responsibility is advising Chase's corporate and institutional clients on international financial problems. He holds a B.A. in economics and an M.B.A. in international finance and economics. He has been an international tax analyst at Texaco, an international economist at Chase and a financial editor and consultant at Business International Corp. Mr. Kramer is an adjunct professor of International Business at the University of South Carolina, adjunct professor of finance at Beaver College, a frequent lecturer on economic and international business matters, and an author of many articles for business publications.

Frederick C. Militello, Jr. – *Vice President,* International Treasury Management Consulting.

Mr. Militello holds a B.A. and M.A. in economics and an M.I.A. degree in international economics from Columbia University. In 1969, he was given the *Wall Street Journal* award in economics and was admitted to the National Social Science Honor Society. He is currently Adjunct Professor of Economics at Pace University. In 1973, he joined Business International Corporation, where he became Assistant Director – Financial Services and Senior Editor of the BI Money Report.

Advance Registration Form

Please register me for THE CHASE INTRODUCTORY SEMINAR ON INTERNATIONAL FINANCIAL MANAGEMENT:

☐ February 4-8, 1980 at the Fontainebleau, Miami, Florida.

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☐ *Enclosed is my registration fee of $975.** ☐ *Bill me* ☐ *Bill my company*

** Fee does not include travel arrangements or hotel accommodations. Please make check payable to The Chase Manhattan Bank, N.A. Additional participants from the same company at the same seminar pay a 50% reduced fee.*

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Ms. Linda A. Ladolcetta
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New York, New York 10081

C

Strong exports a key contributor to Malaysian growth.

The Malaysian economy has continued to expand at a vigorous 8% pace this year. GNP per capita in 1979 is estimated at $1,440, comparable with that of Korea and Taiwan. A strong export performance has been a major influence. Buoyant commodity prices have boosted export growth to 22.4%, bringing total exports to approximately $9.7 billion so far this year. The petroleum sector is leading the export surge with an increase in net earnings of more than 80% to $1.3 billion. The trade balance, which has been in surplus since 1976, will post a surplus of slightly more than $1.0 billion this year, and foreign-exchange reserves are expected to approach $4 billion by year-end. The slowdown in OECD economic growth in 1980 will weaken commodity export receipts, but the Government is unconcerned about curbing imports in view of the favorable long-term growth potential and the country's high creditworthiness on the international capital market.

Portugese prospects brightened by external-account buoyancy.

Despite some disturbing indicators, Portugal's economic prospects appear more promising. Although inflation is now running at slightly less than 24%, with the budget deficit likely to top 121 billion escudos, restrictive credit policies and a depreciating currency have been a boon to the trade balance. Export revenues increased 43% during the first half of 1979, while imports rose only 15%. The current account posted a deficit of $276 million for the first half of 1979; but the gap was more than offset by capital inflows, to yield an overall payments surplus of $220 million. Even with higher oil prices in the second half, Portugal's current-account deficit for 1979 is unlikely to exceed $500 million, compared with a shortfall of $800 million in 1978. In a vote of confidence, the Central Bank has cut its minimum lending rate from 18% to 17% and has reduced its target for the controlled mini-devaluation of the escudo from 0.75% to 0.5% per month.

Hurricane damage to Dominican Republic less than previously feared.

The hurricane that struck the Dominican Republic in September caused a significant amount of damage, but revised estimates of losses are well below those initially feared. Total costs of foregone production and to inventories and productive capacity are estimated at $840 million. Much of the damage of a more permanent nature, however, has been repaired already as part of a three-month emergency program. The agricultural sector suffered the greatest losses, but damage was concentrated in domestically consumed short-cycle crops, production of which has resumed. Export crops were not affected greatly, and, in fact, the sugar crop—the country's major source of foreign-exchange earnings—had been harvested and exported prior to the hurricane. Real GDP growth in 1979, which was estimated at 6% before the hurricane, is now projected at 4.8%. Still, this is significantly better than the 2% growth posted in 1978. And because of insurance payments and international aid, the current-account deficit is expected to shrink from $375 million in 1978 to less than $300 million this year.

Shortfall in world tea crop will fuel price rises.

A continuing drought in India, the world's largest tea producer, is likely to reduce world production this year by 1½%-2% from the record level of 1.48 million metric tons in 1978. World tea consumption, which declined last year largely as a result of a steep drop in U.K. consumption, appears to have strengthened again this year in response to sharply higher coffee prices. While coffee prices are now running 45% above year-ago levels, tea prices are still below their level last year because of a large supply overhang and India's decision to abolish export ceilings and duties. The New York import price of medium-quality tea from Sri Lanka and India has declined steadily from its 1977 high of $2.11 per pound (coinciding with the freeze-induced coffee shortage) to this year's low of 96.4¢ per pound in June, before rising again to $1.06 per pound in October. Some further price gains are anticipated in coming months as currently ample inventories are reduced.

Has Monetary Policy Eased?

While short-term interest rates have fallen significantly from their early November levels, it is improbable that this decline represents an easing of monetary policy. Indeed, a Fed official suggested last week that some market participants had misinterpreted the forces behind the decline. He implied that the decline was consistent with the Fed's new strategy of placing greater emphasis on bank reserves, and less on the Federal funds rate, in controlling money growth. The slowing of growth in both the monetary aggregates and bank reserves since late October has been the major factor behind the weakness of interest rates. By the same token, however, a re-acceleration in money or reserve growth could quickly cause short-term interest rates to rise again. In sum, continued large fluctuations in rates are quite possible in the months ahead.

The recently released minutes of the October Federal Open Market Committee (FOMC) meeting suggest that the recent volatility in interest rates—and the uncertainty it created—were not by themselves viewed as undesirable. This is suggested not only by the exceptionally wide 11½%-15½% trading range for the Federal funds rate set at the meeting, but also by the statement in the minutes that the increased "uncertainty about the near-term course of interest rates . . . should induce banks to exercise greater caution in extending credit and might dampen speculative behavior by increasing its risks and costs."

It was also noted in the minutes that bank reserves in the latter part of October had been growing too rapidly in the FOMC's view to be consistent with fourth-quarter money growth targets. Thus, even with Federal funds trading around 15½%, "continued pressure on money market conditions" appeared appropriate. Since then, however, a significant slowdown in the growth of reserves and the monetary aggregates has coincided with substantial declines in the funds rate.

Obviously, money market rates will remain highly sensitive to movements in the growth of money, reserves, and short-term credit. Nevertheless, it is worth noting that at least part of the recent slowdown in seasonally adjusted M_1 growth appears to be the result of questionable seasonal adjustment factors. These have probably caused the "true" adjusted money growth rate to be understated. Indeed, even before the October 6 policy actions, most money forecasters had projected a slowdown in M_1 growth in the October-November period based on their perception that these seasonal factors were flawed. This seasonal weakness in seasonally adjusted M_1 growth is not expected to continue into December. Moreover, a resurgence in business borrowing—especially around the December tax- and dividend-payment dates—is a distinct possibility. Thus, it seems premature to conclude from the recent behavior of interest rates that they will decline from now well into 1980 without further interruption.

Asia and Oceania — Bimonthly Survey of Business and Finance

	COUNTRIES	CURRENT BUSINESS CONDITIONS	EXPORTS		GNP in 1978		BALANC			
			3 months ending	change from year earlier	in billions of dollars	per capita	latest data	reserves in millions of dollars	12-month change	months of imports covered
Asia	Bangladesh	Severe drought last year left food gap of 3 million tons; December harvest relief awaited.	Apr.	+11%	7.8	$ 93	Sept.	461	+ 49%	4.0
	Burma	Private-sector role constrained by Government's socialist orientation, but free markets thrive.	Aug.	+92%	4.3	135	Sept.	201	+ 48%	5.5
	China, People's Republic	Moderate growth and good harvest in 1979 raise prospects for steady growth in 1980.	June	+40%	445.0	450	June	3,528	+ 12%	3.3
	Hong Kong	Economic boom led by real estate and stock market shows little sign of abatement.	July	+36%	13.3	2,904	n.a.	—	—	—
	India	Low agricultural production, increased political uncertainty, and industrial disputes dampen growth.	June	+ 3%	140.4	219	May	7,506	+ 23%	12.7
	Indonesia	Rice production will fall short of target this year; poor weather a factor.	May	+18%	47.4	326	Sept.	3,341	+ 40%	4.9
	Japan	Higher corporate taxes anticipated in move to reduce dependence on deficit financing.	Aug.	+11%	980.2	8,531	Sept.	25,647	— 14%	4.4
	Korea	Interim government promises to continue Park regime's stabilization policy.	July	+23%	47.4	1,279	July	5,083	+ 18%	4.2
	Malaysia	Budget for 1980 includes largest tax cuts ever for individuals and corporations.	June	+48%	14.9	1,153	July	3,788	+ 30%	7.6
	Pakistan	Government plans to de-nationalize many state-owned enterprises.	July	+21%	18.2	237	Sept.	241	— 67%	0.9
	Philippines	Government launches effort to source foreign funding for $6-billion industrial expansion.	July	+37%	23.3	503	Sept.	2,143	+ 14%	5.4
	Singapore	Shift to higher-technology industries gathers momentum with recent wage hike.	July	+39%	7.7	3,285	June	5,500	+ 24%	5.5
	Sri Lanka	Elimination of food and other subsidies helps reduce budget deficit this year.	May	+ 3%	2.5	173	Sept.	461	+ 34%	6.2
	Taiwan	One year after U.S. de-recognition, economy growing at 8%, with strong foreign investment.	Aug.	+23%	24.0	1,124	Sept.	1,556	0	1.8
	Thailand	Sugar production shortfall prevents fulfillment of ISA export target.	July	+24%	21.7	482	Sept.	2,225	— 2%	5.3
Oceania	Australia	Drought lowers wheat production for 1979/80 season to 14.5 million metric tons.	Sept.	+34%	107.9	7,569	Sept.	4,331	+ 18%	3.7
	Fiji	Revival of building and construction provides impetus for growth in 1979.	June	+15%	0.6	1,142	Sept.	118	— 14%	4.7
	New Zealand	Recent increases in government spending continue to favor consumption over investment.	Aug.	+19%	13.8	4,409	Sept.	631	0	2.5

Savings Ebb as Inflation Persists

Personal saving as a percentage of disposable income was an anemic 4.3% in the third quarter of 1979, and a new monthly series indicates that the rate actually fell below 4% in both September and October. The savings rate has been above 5½% in 85 of the 119 quarters since 1950. Since the third quarter of 1976, however, the rate has consistently been below 5½%.

When faced with increased uncertainty, as in time of war, Americans tend to increase their rate of saving. Unanticipated or accelerating inflation also heightens uncertainty; fears grow that monetary and fiscal restraint will be imposed, leading to cutbacks in production and employment. Individuals respond to the perceived danger of unemployment by saving more to buttress their future standards of living. These fears were justified during the 1950-65 period by the actions of the U.S. Government and the Federal Reserve, whose restrictive policies ensured that outbursts of inflation would not intensify or become prolonged.

Since 1965, however, policymakers' reactions to inflation appear to have changed and, consequently, so have those of savers. Monetary policy, which had been tightened in 1966 in response to accelerating inflation, was eased in 1967 to accommodate the higher Federal spending stemming from the Vietnam War. As a result, a full-scale recession was averted, and unemployment was held down by sharp increases in the armed forces. Inflation soon re-accelerated, but this time there was a difference: people saved less, not more, in 1968-69. With their jobs seemingly secure, they were coping with expected inflation by engaging in "anticipatory buying."

The saving rate did increase sharply in 1970, reflecting a 2½-percentage-point rise in the unemployment rate. But this policy-induced recession failed to eliminate the inflationary expectations formed in the previous four years, since restrictive fiscal and monetary policies were reversed before actual inflation showed any signs of abating. The inflation rate, which accelerated in 1973-74 to 12%, fell by half in the wake of the severe recession. But policy again turned expansionary before inflationary expectations could be reduced to their pre-1973 level. Two subsequent tax cuts, an expanded public-works program, and faster monetary growth have combined to bring about accelerating inflation once again.

Individuals have been borrowing heavily to keep their spending ahead of the expected continuing inflation. But because credit conditions have recently tightened, making a rise in unemployment more probable, the saving rate is likely to turn up from the depths of the late summer and early autumn. Such a forced shift in behavior does not necessarily mean that basic attitudes toward saving have changed. Consumers must be convinced of policymakers' new resolve to fight inflation, despite rising unemployment, before they permanently alter their expectations and increase their level of savings.

OF PAYMENTS		MONEY AND BANKING							COUNTRIES
se of IMF redit, mil- s of dollars	current influences on payments	12-month changes: latest data	consumer prices	latest data	domestic credit	central bank rate (December 5, 1979)	exchange rate in U.S. dollars (December 5, 1979)	current monetary conditions	
220	Growing remittances and foreign aid continue to boost reserves.	Sept.	+17%	July	+ 21%	—	.0650	Credit "squeeze" maintained to fight inflation.	Bangladesh
82	High prices for rice and teak and resumed oil exports are promising.	Aug.	+ 6%	n.a.	—	—	.1550	Monetary policy relaxed to stimulate investment.	Burma
—	Import growth eased in second-half 1979.	n.a.	—	—	—	—	.6800	Soft loans sought from Japan for power and transport projects.	China, People's Republic
—	Exports rising strongly, but imports driven still higher by domestic boom.	July	+12%	Sept.	+ 45%	—	.2015	Credit growth rapid; Government threatens restraint.	Hong Kong
0	Trade gap may reach $2 billion in FY 1980, owing to rising oil imports.	Aug.	+ 9%	July	+ 22%	9.00%	.1245	Credit restrictions unlikely to ease in near future.	India
0	High prices for oil and other commodities promises payments surplus.	Aug.	+26%	May	+ 40%	—	.001650	Money supply continues rapid growth.	Indonesia
0	Large capital outflows undermine yen strength.	Aug.	+ 3%	Aug.	+ 11%	5.25%	.004070	Relatively tight monetary policy continues.	Japan
138	Current-account deficit may exceed $3.5 billion in 1979, as exports lag.	Aug.	+18%	Aug.	+ 36%	15.00%	.0022	Credit remains tight.	Korea
0	Rubber and tin export duties cut; palm oil duties raised.	Aug.	+ 3%	July	+ 8%	—	.4602	Government continues policy of credit expansion.	Malaysia
434	Trade deficit nears $2 billion as imports soar.	Aug.	+12%	June	+ 24%	10.00%	.1020	Credit expanded to small-scale agricultural producers.	Pakistan
628	Payments deficit widens; Government negotiates for new IMF, IBRD credits.	Aug.	+23%	July	+ 27%	4.00%	.1365	Monetary restraint continues.	Philippines
0	Trade deficit may reach $4 billion this year as imports soar.	Aug.	+ 5%	June	+ 14%	—	.4608	Credit conditions remain restrictive.	Singapore
271	First-half trade deficit of $266 million, versus $20 million year earlier.	Aug.	+ 6%	May	+ 35%	10.00%	.0675	Restrictive monetary policy continues.	Sri Lanka
0	Exports to top $15 billion in 1979; current-account surplus likely.	Sept.	+14%	Aug.	+ 21%	14.00%	.0290	Money supply growth at 15%, lowest in years.	Taiwan
239	Trade deficit may reach $1.9 billion in 1979, with oil imports high.	Aug.	+ 7%	June	+ 35%	12.50%	.0510	Credit conditions remain tight to curb inflation.	Thailand
325	Preferential tariff treatment for U.K. suppliers of 500 products dropped.	June	+ 9%	July	+ 13%	—	1.0975	Pressure on short-term rates weakens as U.S. rates fall.	Australia
9	Increased earnings from tourism help offset widening trade deficit.	Aug.	+ 7%	Aug.	+ 34%	—	1.1850	Easy credit maintained to spur investment.	Fiji
392	Recent freight-charge increases worsen invisibles-account deficit.	June	+12%	June	+ 20%	13.00%	.9775	Restrictive credit conditions continue.	New Zealand

World Interest Rates

market rates of December 5, 1979; bond yields as of November 30, 1979

in percent per annum	U.S.	Canada	Britain	Belgium	France	Germany	Italy	Netherlands	Switzerland	Japan
Central Bank Discount Rate	12.00	14.00	17.00	10.00	9.50	6.00	15.00 penalty rate 18.00	9.50	2.00	6.25
Day-to-Day Money	13.125 Dec. 6	14.75	17.00	9.50	12.00	8.80	12.50*	18.50	3.25	8.1875
Treasury Bills 91-day, Middle Rates	11.65	13.55	16.00	14.30 120-day	n. a.	n. a.	12.47* 91-day	no dealing	no market	5.125 2-month
Commercial Paper prime, 3-month, asked	11.75 finance paper	13.80 finance paper 15% tax w/h	14.80	9.90 Certified	12.50 Interbank	no market	no market	no market	no market	not traded
Bankers' Acceptances 3-month, asked	12.65	13.80 15% tax w/h	16.5625	12.00 Certified	not traded	8.40	14.65*	no market	3.25 not traded	no market
Government Bonds Long-term, new and old issues, average yield	10.45	11.25	14.32	10.02 20% tax w/h	11.09	7.85	13.54*	9.08	4.04	8.22
Industrial Bonds prime, long-term, new and old issues, average yield	10.30 Aa Industrials	11.50	14.89	12.42 20% tax w/h	12.33	8.09	14.12*	9.75	5.15	6.94
Bank Short-Term Rate to Best Borrowers (prime rate)	15.25	15.00	18.00	14.75	13.10	10.25	17.00*	14.50	4.00	6.50
Bank Time Deposits 3-month	12.625 Cert. of Dep.	13.75 Cert. of Dep.	16.8125	14.50	12.625	9.45	10.00*	15.50 large deposits	5.625 residents only	4.00 20% tax w/h
Eurocurrencies 3-month, asked	14.1875	no market	16.875	no market	13.75	9.0625	no market	14.25	5.375	no market
Exchange Rates—in U.S.$ rates floating against the $	—	.8572	2.1860	.035310	.2444	.5740	.001228	.5181	.6242	.004071
Forward Exchange Cover 3-month, in percent p.a. *D* = discount, *P* = premium	—	.50 *P*	2.50 *D*	.25 *D*	FLAT	5.00 *P*	3.625 *D*	FLAT	8.125 *P*	5.25 *P*

Eurodollar Deposits
(London, interbank, bid)
December 6

7-day	13.375
1-month	14.125
3-month	14.0625
6-month	13.75

International Arbitrage
(3-month, hedged) + *in favor of U.S. dollars*

U.S.-U.K. Treasury Bills	−1.63
U.S.-Canada Treasury Bills	−1.78
U.S.-Canada Finance Co. Paper	−2.36
Eurodollars-U.K. Local Auth. Deposits	+ .06

Eurbonds
(average yield on recent straight debt issues)

U.S. Dollar Bonds	
7 yrs. and under	11.55
Over 7 yrs.	11.65
DM Bonds	
7 yrs. and under	7.75
Over 7 yrs.	7.875

Gold Price
London afternoon fixing
426.40
(per fine ounce)

The above interest rate quotations refer to the past week and may not be construed as offers by The Chase Manhattan Bank. The quotations for Bank Short-Term Rate to Best Customers, while including customary commissions, reflect neither possible other fees nor varying compensating balance requirements.
* Market Rates as of Nov. 28; bond yields as of Nov. 23.

Irish Economic Indicators

	1977	1978	1979 (est.)	1980 (est.)
Gross Domestic Product*	5.5	5.9	2.7	3.0
Investment as percent of GDP	25.1	26.9	30.0	28.0
Consumer prices*	13.6	7.6	13.0	11.5
Money supply (M_3)*	24.0	24.2	16.0	16.0
Public-sector deficit (£ million)	572.1	866.1	883.1	800.0
Current-account balance (£ million)	−149	−165	−625	−400

* percent change from year earlier

Irish Currency Switches Allegiance

Ireland's economy continues to outperform its European Economic Community (EEC) partners, with real GDP growth of 5.5% in 1977 and nearly 7% in 1978. (See table on bottom page 6.) The twin engines of growth have been exports—primarily agricultural—and investment. These have been encouraged by the Government's continuing commitment to rapid growth and generous tax incentives.

On the external front, strong domestic demand during the last two years has greatly increased imports and widened the trade deficit. The larger trade gap has been partly masked in the far smaller current-account deficit because of aid and grants received from other EEC members.

It is becoming increasingly clear, however, that Ireland's growth rate will decelerate over the next few years. Real GDP is expected to increase only 2.7% this year and an estimated 3.0% in 1980. While this represents a definite slowdown, growth will remain high by historical standards and relative to projected European growth rates. The anticipated economic buoyancy is based on expectations of continued growth increases in the agricultural and export sectors.

The currency issue

An important influence on the future course of economic growth stems from the separation of the Irish currency—the "punt"—from the pound sterling against which it had been pegged on a one-to-one basis. The split from sterling was hailed for providing Ireland the opportunity to pursue an independent monetary policy. What it did in fact do was to force Ireland to accept the monetary consequences of its balance-of-payments position and its domestic budgetary stance.

Under the old system, financial markets viewed the United Kingdom and Ireland as a unified currency area. Even when Ireland's balance-of-payments and budget deficits were large by domestic standards, they appeared small relative to the U.K. monetary system and could be financed without any significant effect on the area's interest-rate structure or exchange rate. Thus, while the separation of the punt has introduced the exchange rate as another policy instrument, it has also altered the policy implications of the old instruments, thereby limiting the Government's freedom of action. Specifically, the balance-of-payments and budget deficits are now viewed in the context of the relatively small Irish economy and will have to be kept within narrow limits if Irish interest rates and the punt exchange rate are to be controlled.

In addition, by joining the European Monetary System (EMS), Ireland has taken on the added pressures of harmonizing its economic performance and policies with those of its stronger and wealthier EMS partners. Indeed, the most important set of problems now facing the authorities stem from the punt's separation from sterling and the imperatives of EMS membership:

- *Wage control.* If the newly independent punt is to participate in the EMS on an equal footing with the other member currencies, wage increases will have to moderate. Wage negotiations have been difficult over the last year, and several long and damaging stoppages have occurred. Settlements have come in at very high levels, with earnings in manufacturing up nearly 15% in 1978 and expected to rise similarly this year. The Government has sought to enlist labor's cooperation by emphasizing that Irish wage increases cannot exceed those granted on the European mainland—assuming comparable labor productivity gains—if the punt is to remain in the EMS with only small adjustments in parity. However, the dominant influence of the U.K. labor market on settlements in Ireland lingers, and there are few signs of any long-term shifts in attitude. This points to the likelihood of several falls in the punt's value within the EMS over the next few years.
- *Balance of payments.* Because of the limited market for the punt in foreign-exchange markets, it is unlikely to come under any heavy speculative pressure. Rather, devaluation pressures will derive from a loss of export competitiveness, which produces, or threatens, a weakened balance of payments and rising unemployment. Thus, the authorities will need to maximize the competitiveness of export industries (partly by curbing wage increases) and check the growth of imports. Nevertheless, with its dependence on imported energy and its relatively rapid pace of growth, Ireland looks set to run a current-account deficit for some years to come. The challenge is to minimize the deficit and sustain the current high level of capital inflows.
- *Monetary policy.* Monetary policy has not yet fully accommodated itself to the fact that with an independent punt the public sector's borrowing is now a major influence on the narrow domestic money market. Large increases in the public-sector deficit have resulted in sharp rises in the nation's money supply growth and significantly higher interest rates.

The monetary authorities have, however, recognized the need for restraint. They introduced guidelines to control credit expansion, and when these had little effect, they announced additional measures that are likely to succeed in significantly reducing the growth rate of domestic credit and the money supply. It is anticipated that the government borrowing requirement will drop sharply in 1980, and that the Irish Central Bank will maintain a restrictive credit policy while proceeding to develop a more mature domestic money market.

J. Nicholas Robinson, Chase London

Paraguay: The New Frontier Economy

Blake Friscia, ***Chase Manhattan Bank's economist for the Western Hemisphere, recently visited Paraguay, where Chase has just opened a new branch in Asuncion. The following are his observations on prospects for the Paraguayan economy.***

Paraguay, historically a country with an isolated and sluggish economy, has entered a dynamic economic development phase. Three large hydroelectric projects underway in the Parana River region bordering Brazil and Argentina have attracted large infusions of investment capital and income. In addition, huge tracts of land are being brought under cultivation and foreign investors are helping to develop such important cash crops as soybeans, cotton, and wheat. Paraguay's potential for becoming the world's largest electricity exporter and a major agro-industrial economy has given it a frontier flavor.

The heady atmosphere reflects a real GDP growth rate that has averaged nearly 10% per year between 1976 and 1978. This compares with real GDP growth of only 4% per annum in the 1965-70 period before the hydroelectric projects were launched. For 1979, real GDP is expected to advance by an impressive 9%.

The hydroelectric potential. Three major hydroelectric projects along the Parana River—Itaipu, Yacyreta, and Corpus—will eventually produce 100 billion kilowatt hours of electricity per year. The $9-billion Itaipu construction project, which is being constructed together with Brazil, will become the world's largest hydroelectric facility. Itaipu will expand Paraguay's electric generation capacity by 40 times and will permit large electricity exports to Brazil. As for the other projects, the Yacyreta is just now being started and Corpus is in the planning stages. These smaller hydroelectric facilities are being constructed in partnership with Argentina. The three projects are important not only for the direct electricity production and the construction jobs and income that they will generate for Paraguay, but also for unleashing vast potential for energy-intensive industrial development.

The agricultural base. Agriculture dominates the Paraguayan economy, accounting for about one-third of GDP and some 95% of total exports. Traditionally, Paraguay's agricultural output has concentrated on crops such as corn and tobacco and on the raising of beef cattle. But in the past five years there has been a phenomenal increase in the production of soybeans and cotton, which have become Paraguay's leading farm exports.

Inflationary pressures. The boom in construction, higher oil prices, and imported inflation have combined to accelerate the domestic inflation rate during the past year. Previously, Paraguay's inflation was relatively moderate, with price rises averaging 4.5% per annum as recently as 1976. But the rate of price increases jumped sharply to 9.4% in 1977 and to 10.6% in 1978. And during the first six months of 1979, consumer prices rose at an annual rate approaching 15%, compared with the previous year. The inflation rate shot up even higher in the third quarter of 1979 to 33% above the year-earlier level. Paraguay's mounting inflation has led to pressures for salary increases, and last June the Government authorized a 15% increase in minimum wages. In fact, since February 1978 the minimum-wage scale has risen 45%. To counter the resulting inflationary pressures, the Government has relied on restrictive fiscal and monetary policies. The central government budget has shown surpluses since 1973, and in the first half of 1979 the excess of income over expenditures was up 12% over the previous year. The growth of money has also been constrained in 1979, rising by 25% this past June, compared with 35% a year earlier. High commercial-bank reserve requirements and other credit limits have been used to curb excessive domestic money creation.

Balance of payments and external debt. Paraguay's balance-of-payments position has generally been one of running current-account deficits that are financed with capital inflows related to the dam projects and other ventures. This has permitted a strong overall balance-of-payments position in recent years, and international reserves (less gold) have jumped from $157 million at the end of 1976 to $622 million in October 1979. Moreover, since Paraguay has a very open international economy, there are substantial foreign-exchange movements associated with unrecorded trade.

Paraguay's total external debt reached $690 million in June 1979, an increase of 3% over the previous year, but still small relative to projected GDP for 1979. The creditworthiness of the country is attested to by a relatively low external debt-service ratio of 10%-11% during the period 1975-78.

Growth prospects. The combination of the hydroelectric projects, the cultivation of new agricultural lands, and the country's good measure of political stability point to an annual growth potential of about 8%-9% for Paraguay over the next few years. Private investment capital and additional managerial resources, along with public infrastructural improvements, will be needed to realize this high-growth momentum, and inflationary pressures will have to be kept within reasonable limits. For the international business community, these prospects suggest interesting investment possibilities.